



California Public Employees' Retirement System
Constituent Relations Office
P.O. Box 1494
Sacramento, CA 94229-1494
TTY: (916) 795-3240
(888) CalPERS (225-7377) • (916) 795-2744 fax
www.calpers.ca.gov

Agenda Item 7b

March 15, 2011

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

- I. SUBJECT:** Establishment of Three Asset Allocations for the California Employers' Retiree Benefit Trust
- II. PROGRAM:** California Employers' Retiree Benefit Trust (CERBT)
- III. RECOMMENDATION:** Staff recommends that the Committee accepts and recommends to the full Board the establishment of three asset allocation strategies for the CERBT.
- IV. ANALYSIS:**

In the case of pension benefits in the CalPERS system, the CalPERS Board of Administration is responsible for measuring liabilities and for setting employer pre-funding policy. In this case, the CalPERS Board determines the amount and timing of pension pre-funding contributions required from participating employers.

In the case of Other Post Employment Benefits (OPEB), this responsibility lies with the participating employers, not with the CalPERS Board. Public employers are responsible for measuring their OPEB liabilities and for determining their pre-funding policy. Participating CERBT employers decide the amount and timing of their contributions to the trust.

The public employer's responsibility for OPEB cost measurement and for OPEB pre-funding policy is recognized in Governmental Accounting Standard Board (GASB) Statement Numbers 43 and 45, and in CERBT participation agreement, policies, and procedures. For example, the CalPERS CERBT Participation Agreement stipulates, among other things, that:

- Employer contributions to the CERBT are voluntary
- Employers provide a "Certification of OPEB Funding Policy" to the CERBT
- CERBT employers can diverge from the CalPERS OPEB actuarial assumptions model if doing so reflects their local plan attributes more closely.

The CERBT program follows these practices because public employers are responsible for measuring their own OPEB costs and for determining their own OPEB pre-funding policy.

The CalPERS Board of Administration is responsible for CERBT investment policy and management. Although participating employers decide how much to contribute to the CERBT and when, the CalPERS Board of Administration decides in what manner the employer contributions will be invested.

There are strong, direct relationships between investment policy, cost measurement and pre-funding policy. Investment return, the volatility of returns, and the associated discount rate directly influence cost measurement and pre-funding policy. Some CERBT employers whose benefit plans or governance groups have particular characteristics are likely to benefit from having more than one investment return/risk choice available to them.

Here are some examples of such OPEB plan characteristics:

1. A plan is extremely well funded and the employer prefers lower asset risk in exchange for higher ARC and measured liabilities.
2. A plan is required to make substantial payments from trust assets in the near future and requires greater asset stability in the near future.
3. A governing body responsible for pre-funding policy prefers more stable (albeit higher) ARC and measured liabilities to provide more consistency in financial plans and budgets.

Some CERBT employers have these characteristics and have asked for asset allocation strategies with less volatile expected returns.

After study and consultation with staff of the Investment Office and of Fiscal Services, CERBT program staff developed a plan to provide three asset allocation strategies in a manner consistent with the program's commitment to simple administrative processes and low cost. These asset allocation strategies will offer a range of expected investment return and volatility of expected returns that we anticipate will be suitable for the CERBT employer population.

Here are the important features of the plan.

1. No new or additional asset classes are required. Each strategy relies on the same set of asset classes. Investment return and risk differ based on the degree of participation in each asset class.
2. Employers will not change strategies often. The choice of an asset allocation strategy is tied to the biennial OPEB valuation. Once made, we expect changes to be very infrequent.
3. Accounting for the assets and investment return is compatible with the current record keeping system and with the new record keeping system to be implemented by INVO in July 2011.
4. The implementation of the strategies will be tied to the OPEB valuation reports dated 6/30/2011, and biennially thereafter. Transactions will be minimized by grouping and recognizing changes one time in a calendar quarter.

If approved, the implementation of these three asset allocation strategies will occur at the beginning of July 2011. The implementation is timed to coincide with the implementation of GASB 57. GASB 57 requires all CERBT employers to perform a new biennial OPEB actuarial cost valuation report to cover the fiscal year periods FY 011-12 and FY2012-13. The start of a new biennial OPEB cost report cycle is an appropriate time to recognize new asset allocation strategies and the associated discount rates used in the actuarial cost reports.

Both participating employers and internal staff (INVO and FCSD) find the timing to be appropriate because it comes at the beginning of the new fiscal year. All participating employers have been advised about the GASB 57 requirement of a new actuarial OPEB cost report (dated 6/30/2011 and biennially thereafter), and about CERBT staff's intention to recommend additional asset allocation strategies to this committee. If approved, staff expects several employers to adopt a strategy with less volatile expected returns for the reasons cited above.

This proposal will be implemented mainly by applying elements of the CERBT program that exist now or will exist whether or not these additional asset allocation strategies are approved. We do not expect the implementation of this proposal to change materially the ongoing cost of the current CERBT program.

V. STRATEGIC PLAN:

This item is not a specific product of the Strategic or Annual Plans but is part of the regular and ongoing workload of the Actuarial & Employer Services Division.

VI. RESULTS/COSTS:

See above.

RAND ANDERSON, Chief
Constituent Relations Office

ALAN MILLIGAN
Chief Actuary